



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street

Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

UIL: 501.03-01

Number: 200829034

Release Date: 7/18/2008

LEGEND

ORG = Organization

XX = Date

Address = address

Date: March 17, 2008

ORG

ADDRESS

Person to Contact:

Badge Number:

Contact Telephone Number:

Contact Address:

Last Date for Filing Petition:

June 11, 20XX

CERTIFIED MAIL and RETURN RECEIPT

Dear :

This is a final revocation letter as to your exempt status under section 501(c) (3) of the Internal Revenue Code. The recognition of your exemption under Internal Revenue Code section 501(c) (3) is revoked beginning June 9, 19XX for the following reason(s):

You have not been operated exclusively for an exempt purpose as required by Internal Revenue Code section 501(c) (3). You have not demonstrated that you engage primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3) and as required by Treas. Reg. section 1.501(c)(3)-1(c)(1). Your net assets also inure to the benefit of private individuals. You have not demonstrated that you operated as required by Treas. Reg. section 1.501(c)(3)-1(c)(2).

Contributions to your organization are no longer deductible effective January 1, 20XX.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia before the (ninety-first) 91st day after the date that this determination was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment by referring to the enclosed Publication 892.

You may write to the United States Tax Court at the following address: United States Tax Court 400 Second Street, NW Washington, DC 20217

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for the Taxpayer Advocate assistance or you can contact the Advocate from the site where this issue was determined by writing to:

Taxpayer Advocate assistance cannot be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State officials of this action, as required by section 6104(c) of the Internal Revenue Code.

As a result of this revocation of tax-exempt status, your organization is required to file Form 1120 annually with the appropriate Campus identified in the instructions.

This letter is a final revocation letter and should be kept within your permanent records.

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely,

Marsha Ramirez
Director, EO Examinations

Enclosures:
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
1100 Commerce Street
Dallas, TX 75242

April 6, 2007

ORG
ADDRESS

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 20XX, 20XX, 20XX

LEGEND

ORG = Organization name XX = Date Founder = Founder Founder 2 =
2nd founder CO-1 = 1st company XYZ = State

PRIMARY ISSUE: Whether the IRC § 501(c)(3) tax exempt status of ORG should be revoked because it is not operated exclusively for tax exempt purposes.

FACTS:

ORG (the "Organization") was created with Articles of Incorporation ("Articles") on June 9, 19XX, by Founder (the "Founder"). Founder is the only person listed as a director in the Articles. The Articles state the Organization is organized as a non-profit corporation within the meaning of Section 501(c)(3) of the Internal Revenue Code and will carry on any lawful activity permitted for a non-profit corporation. Section 4.03 of the Articles provides that no part of the net earnings will inure to the benefit of or be distributed to the members, trustees, officers or other private persons. The Articles do not specify a supported organization.

The Articles provide that the Organization will distribute its income each year following the rules of Section 4942 and that it will not engage in any act of self-dealing as defined in Section 4941(d) of the Internal Revenue Code.

The Organization's Form 1023 (Application for Exemption) ("Application") was filed with the Internal Revenue Service on January 3, 20XX. According to the Application, no donations had been received by the Organization and there were no assets. The Application was signed by Founder. Based on the representations in the Application (see below), on April 5, 20XX the Organization was recognized as an exempt organization described in section 501(c)(3) of the Internal Revenue Code and it was classified as a supporting organization described in section 509(a)(3) effective June 9, 19XX.

The Application provides that the Organization has been established solely to support the activities of CO-1. CO-1 is a nonprofit corporation headquartered in XYZ. The Application states the supported organization must approve all resolutions of the Board of Directors of the Organization, including investment decisions. The By-Laws provide that all actions of the Board of Directors will be subject to the written approval of CO-1 or its designated representative or representatives. The By-laws further state that it is intended that control of the Organization be vested in CO-1.

The Articles provide that upon dissolution the remaining assets of the Organization will be disposed of to an organization or organizations that are organized and operated exclusively for charitable, educational, religious, or scientific purposes that qualify for exempt status under Section 501(c)(3) of the Internal Revenue Code. The Board of Directors shall determine who will receive the assets.

The Articles listed only one director of the Organization at the time of filing. The Application lists two directors, Founder and his wife Founder 2. The By-laws provide there will be at least five directors and the appointment of directors will be approved by CO-1. During the application process the Organization was asked for additional board members. It provided four additional names as board members. The Organization has no documentation that CO-1 approved the directors.

According to the response to our questionnaire of September 26, 20XX, the Organization only has two directors; Founder and Founder 2. The Forms 990 for 20XX-20XX list only directors, Founder and Founder 2.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
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Minutes of the meetings of the Board of Directors, for the years 20XX, 20XX and 20XX, were requested but none have been provided.

On January 1, 20XX, the Founder transferred his certificate of ownership in CO-2 ("CO-2") to the Organization. The certificate was for a thirty-three and a third percent ownership in the CO-2.

On January 1, 20XX, the Organization sold its one-third ownership in the CO-2 to the other two owners for \$.

On January 2, 20XX, the Organization loaned \$ to Founder. The promissory note, which is dated January 2, 20XX,¹ shows it is a demand note with 6% interest. The note has no provisions for interest payments until the note is repaid. The Form 990 for year ending December 31, 20XX states there was no collateral for the note. The Form 990 indicates the loan was made for purpose of receiving investment income.

The following chart shows the total income, assets at the end of the year and the grants paid out by the Organization for the years 20XX – 20XX. These amounts were taken from the Organization's Forms 990 (Return of Organization Exempt from Tax).

	20XX	20XX	20XX	20XX	20XX	20XX
Total revenue						
Contributions						
Interest						
Rents						
Sales of assets						
Asset - Cash						
Investments						
Loans to officers						
Grants paid out						

The income received in the year 20XX included a cash contribution of \$, rental income of \$ and the value of the one-third interest in the CO-2, \$. The grant paid out in 20XX was made to

. The income shown in 20XX and 20XX was from rents. The investment is the one-third interest in the CO-2. The increase to the investments each year was the rental income.

According to responses to the Service's questionnaire, Founder deducted the following amounts as charitable contribution deductions on his personal returns: \$ in 19XX, \$ in 20XX and \$ in 20XX.

* * * *

¹ The Forms 990 for 20XX-20XX state the note is dated May 27, 20XX.

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LAW:

IRC § 501(c)(3) exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Regulation section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Regulation section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Regulation section 1.501(c)(3)-1(d)(1)(ii) provides an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the United States Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under section 501(c)(3).

In Founding Church of Scientology v. U.S., 412 F. 2d 1197 (Ct. Cl. 1969) the court stated that loans to an organization's founder or substantial contributor can constitute inurement that is prohibited under section 501(c)(3). In that case, the church made loans to its founder and his family and failed to produce documentation that demonstrated that the loans were advantageous to the church. The church also failed to produce documentation to show that the loans were repaid. Significantly, the court stated that "the very existence of private source of loan credit from an organization's earnings may itself amount to inurement of benefit."

In Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under section 501(c)(3)

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Greg R. Vinikoor v Commissioner, T.C. Memo. 1998-152 examines whether there is a valid loan and opines that it depends on whether a transfer was made with a real expectation of repayment and an intention to enforce the debt which depends on all the facts and circumstances.

Patrick v. Commissioner, T.C. Memo. 1998-30 also set down criteria to determine if a loan existed.

Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959).

Haag v. Commissioner, 88 T.C. 604, 615 (1987)

Section 601.201(n)(6)(i) of the Regulations provides that an organization may be revoked retroactively if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or it engaged in a prohibitive transaction of the type described in Section 601.210(n)(6)(vii). The types of prohibited transactions referred to are those that divert corpus or income from the organization's exempt purpose.

GOVERNMENT'S POSITION

The IRC § 501(c)(3) tax exempt status of the ORG (the "Organization") should be revoked because the assets of the Organization inured to the benefit of the Founder, Founder, and it is not operated exclusively for tax exempt purposes.

An organization must be both organized and operated exclusively for one or more of the purposes specified in Section 501(c)(3) of the Internal Revenue Code. Whether an organization has satisfied the operational test is a question of fact.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes. The requirement that an organization operate exclusively for charitable purposes is further amplified in section 1.501(c)(3)-1(c)(1) of the regulations. This section provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. In the case of Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Court concluded that the presence of a single nonexempt purpose, if substantial in nature, would preclude exemption regardless of the number or importance of statutorily exempt purposes.

The Organization received "contributions" in 20XX. The rental income shown in other years was not received in cash, the amount was added to the value of the investment in the CO-2.

The facts show that the Organization is not operated exclusively for a tax exempt charitable purpose. Rather, the Founder has operated the Organization for his own personal benefit. The terms of the

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promissory note, i.e., the lack of interest payments being required or received on the loan, the timing of the sale of the Organization's only asset and the disbursement of the monies to Founder purportedly as a loan, and the lack of collateral show the Organization is being operated for the benefit of the Founder.

In 20XX, the Organization received cash and a one-third interest in a CO-2. That is the only year it made a grant and the grant was not to CO-1. It did not receive rental income from its interest in the CO-2, the rents were added to the value of the CO-2. On January 1, 20XX, the Organization sold its one-third interest in the CO-2 and disbursed the proceeds the next day to the Founder. There is a promissory note, but it is a demand note with no requirements of periodic interest payments. No interest has been received. The Founder has control of the assets because he and his wife are the only board members. They are the ones who would have to demand payment of the note. The terms of the note show the Organization let the Founder set up the terms for his own benefit and not for the benefit of the Organization.

In Greg R. Vinikoor v. Commissioner, T.C. Memo. 1998-152, the court used nine factors to determine if a loan existed: 1) there was a promissory note or other evidence of indebtedness; 2) interest was charged; 3) there was security or collateral; 4) there was a fixed maturity date; 5) a demand for repayment was made; 6) an actual repayment was made; 7) the transferee had the ability to repay; 8) any records maintained by the transferor and/or transferee reflected the transaction as a loan; and 9) the manner in which the transaction was reported for Federal Tax purposes is consistent with a loan.

In Patrick v Commissioner, T.C. Memo. 1998-30, the following criteria was used to determine if a loan existed: 1) the existence or nonexistence of a debt instrument; 2) provisions for security, interest payments, and a fixed repayment date; 3) whether the parties' records, if any, reflect the transaction as a loan; 4) the source of repayment and ability to repay; 5) the relationship of the parties; 6) whether any repayments have been made; 7) whether a demand for repayment has been made; and 8) failure to pay on the due date or to seek a postponement.

For a payment to constitute a loan, when the payments are received, the recipient must intend to repay the amounts and the transferor must intend to enforce payment. Haag v. Commissioner, 88 T.C. 604, 615 (1987), aff'd without published opinion, 855 F.2d 855 (8th Cir. 1988); Beaver v. Commissioner, 55 T.C. 85, 91 (1970).

In this case there is a promissory note between Founder and the Organization. There is no indication that Founder intends to pay the note or that the Organization expects to receive payment. The note contains no set dates for interest payments or a fixed maturity date. There is no collateral. The only officers and directors of the Organization are Founder and his wife therefore they make the decisions of the Organization and would have to demand repayment of the loan. They would have to enforce the terms of the note against Founder. The documents provided by the Organization state that Founder had experienced financial reversals in 20XX and 20XX and does not have the ability to repay the money. Based on all of these factors the amount transferred to Founder is not a loan.

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An organization is described in section 501(c)(3) only if no part of its net earnings inures to the benefit of any private shareholder. The inurement prohibition is designed to insure that charitable assets are dedicated to exclusively furthering public purposes. An organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private shareholders or individuals.

A charity's assets are required to be irrevocably dedicated to charitable purposes. Treas. Reg. § 1.501(c)(3)-1(b)(4). The inurement prohibition serves to prevent the individuals who operate the charity from siphoning off any of a charity's income or assets for personal use. See United Cancer Council v. Commissioner, 165 F3d 1173 (7th Cir. 1999). By transferring its assets to Founder, the Organization breached the dedication requirement and its net earnings have inured to the benefit of Founder.

Although the inurement prohibition is stated in terms of net earnings, it applies to any of a charity's assets that serve the interests of its private shareholders. Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1072 (6th Cir. 1974). The Organization has operated since inception primarily for the benefit of its Founder.

The Organization, which is controlled by the Founder, is operated to enable the Founder to engage in financial activities which are beneficial to him, but detrimental to the Organization. Accordingly, it is operated for a substantial non-exempt purpose. See Revenue Ruling 67-5.

According to Regulation section 1.501(c)(3)-1(d)(1)(ii) an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. As stated in Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959), loans to disqualified persons can promote private rather than charitable purposes. Founder is a disqualified person because he is a substantial contributor and director of the Organization.

The very presence of a private source of loan credit may amount to inurement. Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969).

CONCLUSION

The Application and By-laws stated that the purpose of the Organization would be to support CO-1, that all actions of the Organization's board of directors was subject to the written approval of CO-1 and the control of the Organization would be vested in CO-1. There is no evidence that CO-1 has been involved in any of the decisions of the Organization's Board. The Organization did not state that it would transfer all of its assets to its Founder for no consideration. The Organization should be revoked back to inception because it misstated a material fact on its application, has not been operating in the manner it represented, and it has operated in a manner whereby its assets inured to the benefit of its Founder.

Accordingly, the Organization's status as an organization described under section 501(c)(3) should be revoked, effective June 9, 19XX, because it did not operate exclusively for exempt purposes, its assets inured to the Founder, and it served the private interests of its creator.

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Form 1041 U.S. Income Tax Return for Estates and Trusts should be filed for tax years ending December 31,[please insert all open years]. Subsequent returns are due no later than the 15th day of the 4th month following the close of the trust's accounting period.

Returns should be sent to the following mailing address:

Internal Revenue Service

For tax year ending December 31, 20XX, the Form 1041 is due April 15, 20XX, and should be sent to the following address:

Internal Revenue Service Center

Alternative Issue # 1: Whether the ORG should be reclassified as a private foundation.

FACTS

See Facts above as well as the information below.

The Organization was recognized as an organization described in section 501(c)(3) on April 9, 20XX, and was classified as a supporting organization described in section 509(a)(3). This determination was effective June 9, 19XX.

The following chart shows the income and expenses of the Organization. The information is a compilation of information shown on the Forms 990 for 20XX, 20XX, 20XX, and 20XX, on the Support Schedule of the Schedule A of the Form 990 for 20XX and answers to the questionnaire mailed to the Organization on September 26, 20XX.

	20XX12	20XX12	20XX12	20XX12	20XX12	20XX12
Income						
contribution						
s						
rents						
sale of asset						
expenses						
grants paid						
bk charges						
balance						
sheet						
cash boy						
cash eoy						

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investments
beg of year
end of year

loan to
officer
beg of year
end of year

The Application provides that the Organization has been established solely to support the activities of CO-1. CO-1 is a nonprofit corporation headquartered in XYZ. The Application states the supported organization must approve all resolutions of the Board of Directors of the Organization, including investment decisions. The By-Laws provide that all actions of the Board of Directors will be subject to the written approval of CO-1 or its designated representative or representatives. The By-laws further state that it is intended that control of the Organization be vested in CO-1.

The By-laws provide that the following actions shall be subject to the written approval of CO-1 or the designated representative of CO-1: 1) amending the Articles of Incorporation or Bylaws, 2) terminating the federal tax exempt status, 3) merger, consolidation, liquidating or dissolving the Organization, or 4) selling all or substantially all of the assets of the Organization.

The Articles of Incorporation does not mention supporting CO-1.

The Organization has never paid any grants to CO-1 or performed any activities for the benefit of CO-1.

LAW:

IRC § 509(a)(3) provides that an organization is not a private foundation if it is organized and operated exclusively for the benefit of or to support a public charity, it is operated, supervised or controlled by or in connection with one or more public charities and it is not controlled, directly or indirectly, by one or more disqualified persons.

Income Tax Regulations section 1.509(a)-4(c) regarding the organizational test a 509(a)(3) organization must meet provides:

(1) *In general.* —An organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) only if its articles of organization (as defined in §1.501(c)(3)-1(b)(2)):

- (i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);
- (ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;
- (iii) State the specified publicly supported organizations on whose behalf such organization is to be operated (within the meaning of paragraph (d) of this section); and

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(iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

Income Tax Regulations section 1.509(a)-4(e) regarding the operational test a 509(a)(3) organization must meet provides:

(1) *Permissible beneficiaries.* —A supporting organization will be regarded as “operated exclusively” to support one or more specified publicly supported organizations (hereinafter referred to as the “operational test”) only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. A supporting organization may also, for example, make a payment indirectly through another unrelated organization to a member of a charitable class benefited by a specified publicly supported organization, but only if such a payment constitutes a grant to an individual rather than a grant to an organization. In determining whether a grant is indirectly to an individual rather than to an organization the same standard shall be applied as in §53.4945-4(a)(4) of this chapter. Similarly, an organization will be regarded as “operated exclusively” to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

(2) *Permissible activities.* —A supporting organization is not required to pay over its income to the publicly supported organizations in order to meet the operational test. It may satisfy the test by using its income to carry on an independent activity or program which supports or benefits the specified publicly supported organizations. All such support must, however, be limited to permissible beneficiaries in accordance with subparagraph (1) of this paragraph. The supporting organization may also engage in fund raising activities, such as solicitations, fund raising dinners, and unrelated trade or business to raise funds for the publicly supported organizations, or for the permissible beneficiaries.

Income Tax Regulations section 1.509(a)-4(f) regarding the nature of relationships required for section 509(a)(3) organizations provides:

(1) *In general.* —Section 509(a)(3)(B) describes the nature of the relationship required between a section 501(c)(3) organization and one or more publicly supported organizations in order for such section 501(c)(3) organization to qualify under the provisions of section 509(a)(3). To meet the requirements of section 509(a)(3), an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. If an

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organization does not stand in one of such relationships (as provided in this paragraph) to one or more publicly supported organizations, it is not an organization described in section 509(a)(3).

(2) *Types of relationships.* —Section 509(a)(3)(B) sets forth three different types of relationships, one of which must be met in order to meet the requirements of subparagraph (1) of this paragraph. Thus, a supporting organization may be:

- (i) Operated, supervised, or controlled by,
- (ii) Supervised or controlled in connection with, or
- (iii) Operated in connection with, one or more publicly supported organizations.

(3) *Requirements of relationships.* —Although more than one type of relationship may exist in any one case, any relationship described in section 509(a)(3)(B) must insure that:

(i) The supporting organization will be responsive to the needs or demands of one or more publicly supported organizations; and

(ii) The supporting organization will constitute an integral part of, or maintain a significant involvement in, the operations of one or more publicly supported organizations.

(4) *General description of relationships.* —In the case of supporting organizations which are “operated, supervised, or controlled by” one or more publicly supported organizations, the distinguishing feature of this type of relationship is the presence of a substantial degree of direction by the publicly supported organizations over the conduct of the supporting organization, as described in paragraph (g) of this section. In the case of supporting organizations which are “supervised or controlled in connection with” one or more publicly supported organizations, the distinguishing feature is the presence of common supervision or control among the governing bodies of all organizations involved, such as the presence of common directors, as described in paragraph (h) of this section. In the case of a supporting organization which is “operated in connection with” one or more publicly supported organizations, the distinguishing feature is that the supporting organization is responsive to, and significantly involved in the operations of, the publicly supported organization, as described in paragraph (i) of this section.

Income Tax Regulations section 1.509(a)-4(g)(1) provides guidance on the meaning of “operated, supervised, or controlled by” as follows:

(i) Each of the items “operated by”, “supervised by”, and “controlled by”, as used in section 509(a)(3)(B), presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under any one of these terms is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing

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body, members of the governing body, officers acting in their official capacity, or the membership of one or more publicly supported organizations.

(ii) A supporting organization may be “operated, supervised or controlled by” one or more publicly supported organizations within the meaning of section 509(a)(3)(B) even though its governing body is not comprised of representatives of the specified publicly supported organizations for whose benefit it is operated within the meaning of section 509(a)(3)(A). A supporting organization may be “operated, supervised, or controlled by” one or more publicly supported organizations (within the meaning of section 509(a)(3)(B)) and be operated “for the benefit of” one or more different publicly supported organizations (within the meaning of section 509(a)(3)(A)) only if it can be demonstrated that the purposes of the former organizations are carried out by benefiting the latter organizations.

Income Tax Regulations section 1.509(a)-4(h) provides guidance on the meaning of “supervised or controlled in connection with” as follows:

(1) In order for a supporting organization to be “supervised or controlled in connection with” one or more publicly supported organizations, there must be common supervision or control by the persons supervising or controlling both the supporting organization and the publicly supported organizations to insure that the supporting organization will be responsive to the needs and requirements of the publicly supported organizations. Therefore, in order to meet such requirement, the control or management of the supporting organization must be vested in the same persons that control or manage the publicly supported organizations.

(2) A supporting organization will not be considered to be “supervised or controlled in connection with” one or more publicly supported organizations if such organization merely makes payments (mandatory or discretionary) to one or more named publicly supported organizations, even if the obligation to make payments to the named beneficiaries is enforceable under state law by such beneficiaries and the supporting organization's governing instrument contains provisions whose effect is described in section 508(e)(1)(A) and (B). Such arrangements do not provide a sufficient “connection” between the payor organization and the needs and requirements of the publicly supported organization to constitute supervisions or control in connection with such organizations.

Income Tax Regulations section 1.509(a)-4(i) provides guidance on the meaning of “operated in connection with” as follows:

(1) *General rule*

(i) Except as provided in subdivisions (ii) and (iii) of this subparagraph and subparagraph (4) of this paragraph, a supporting organization will be considered as being operated in connection with one or more publicly supported organizations only if it meets the “responsiveness test” which is defined in subparagraph (2) of this paragraph and the “integral part test” which is defined in subparagraph (3) of this paragraph.

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(2) Responsiveness test

(i) For purposes of this paragraph, a supporting organization will be considered to meet the "responsiveness test" if the organization is responsive to the needs or demands of the publicly supported organizations within the meaning of this subparagraph. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii)

(a) One or more officers, directors, or trustees of the supporting organization are elected or appointed by the officers, directors, trustees, or membership of the publicly supported organizations;

(b) One or more members of the governing bodies of the publicly supported organizations are also officers, directors or trustees of, or hold other important offices in, the supporting organizations; or

(c) The officers, directors or trustees of the supporting organization maintain a close and continuous working relationship with the officers, directors or trustees of the publicly supported organizations; and

(d) By reason of (a), (b), or (c) of this subdivision, the officers, directors or trustees of the publicly supported organizations have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making them, and the selection of recipients of such supporting organization, and in otherwise directing the use of the income or assets of such supporting organization.

(iii)

(a) The supporting organization is a charitable trust under State law;

(b) Each specified publicly supported organization is a named beneficiary under such charitable trust's governing instrument; and

(c) The beneficiary organization has the power to enforce the trust and compel an accounting under State law.

(3) Integral part test; general rule

(i) For purposes of this paragraph, a supporting organization will be considered to meet the "integral part test" if it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii) The activities engaged in for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations,

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and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves.

(iii)

(a) The supporting organization makes payments of substantially all of its income to or for the use of one or more publicly supported organizations, and the amount of support received by one or more of such publicly supported organizations is sufficient to insure the attentiveness of such organizations to the operations of the supporting organization. In addition, a substantial amount of the total support of the supporting organization must go to those publicly supported organizations which meet the attentiveness requirement of this subdivision with respect to such supporting organization. Except as provided in (b) of this subdivision, the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. In applying the preceding sentence, if such supporting organization makes payments to, or for the use of, a particular department or school of a university, hospital or church, the total support of the department or school shall be substituted for the total support of the beneficiary organization.

(b) Even where the amount of support received by a publicly supported beneficiary organization does not represent a sufficient part of the beneficiary organization's total support, the amount of support received from a supporting organization may be sufficient to meet the requirements of this subdivision if it can be demonstrated that in order to avoid the interruption of the carrying on of a particular function or activity, the beneficiary organization will be sufficiently attentive to the operations of the supporting organization. This may be the case where either the supporting organization or the beneficiary organization earmarks the support received from the supporting organization for a particular program or activity, even if such program or activity is not the beneficiary organization's primary program or activity so long as such program or activity is a substantial one.

....

(d) All pertinent factors, including the number of beneficiaries, the length and nature of the relationship between the beneficiary and supporting organization and the purpose to which the funds are put (as illustrated by subdivision (iii)(b) and (c) of this subparagraph), will be considered in determining whether the amount of support received by a publicly supported beneficiary organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization. Normally the attentiveness of a beneficiary organization is motivated by reason of the amounts received from the supporting organization. Thus, the more substantial the amount involved, in terms of a percentage of the publicly supported organization's total support the greater the likelihood that the required degree of attentiveness will be present. However, in determining whether the amount received from the supporting organization is sufficient to insure the attentiveness of the beneficiary organization to the

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operations of the supporting organization (including attentiveness to the nature and yield of such supporting organization's investments), evidence of actual attentiveness by the beneficiary organization is of almost equal importance. An example of acceptable evidence of actual attentiveness is the imposition of a requirement that the supporting organization furnish reports at least annually for taxable years beginning after December 31, 1971, to the beneficiary organization to assist such beneficiary organization in insuring that the supporting organization has invested its endowment in assets productive of a reasonable rate of return (taking appreciation into account) and has not engaged in any activity which would give rise to liability for a tax imposed under sections 4941, 4943, 4944, or 4945 if such organization were a private foundation. The imposition of such requirement within 120 days after October 16, 1972, will be deemed to have retroactive effect to January 1, 1970, for purposes of determining whether a supporting organization has met the requirements of this subdivision for its first two taxable years beginning after December 31, 1969. The imposition of such requirement is, however, merely one of the factors in determining whether a supporting organization is complying with this subdivision and the absence of such requirement will not preclude an organization from classification as a supporting organization based on other factors.

(e) However, where none of the beneficiary organizations is dependent upon the supporting organization for a sufficient amount of the beneficiary organization's support within the meaning of this subdivision, the requirements of this subparagraph will not be satisfied, even though such beneficiary organizations have enforceable rights against such organization under State law.

Rev. Rul. 76-208, 1976-1 C.B. 161, held that a charitable trust described in section 501(c)(3) did not satisfy the "substantially all" requirement of the integral part test set forth in section 1.509(a)-4(i)(3)(iii)(A) of the regulations and was therefore not a supporting organization. The trust instrument provided that 75 percent of the trust income was to be distributed annually to a specified church with the remaining 25 percent to accumulate until the original corpus doubled, at which time the entire annual income was to be distributed to the church. The Service also stated that for purposes of the integral part test, the term "substantially all" means 85 percent or more.

Income Tax Regulations section 1.509(a)-4(j) regarding control by disqualified persons provides:

- (1) *In general.* —Under the provisions of section 509(a)(3)(C) a supporting organization may not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more publicly supported organizations. If a person who is a disqualified person with respect to a supporting organization, such as a substantial contributor to the supporting organization, is appointed or designated as a foundation manager of the supporting organization by a publicly supported beneficiary organization to serve as the representative of such publicly

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supported organization, then for purposes of this paragraph such person will be regarded as a disqualified person, rather than as a representative of the publicly supported organization. An organization will be considered "controlled", for purposes of section 509(a)(3)(C), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of any substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization. Except as provided in subparagraph (2) of this paragraph, a supporting organization will be considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of the total voting power of the organization's governing body or if one or more of such persons have the right to exercise veto power over the actions of the organization. Thus, if the governing body of a foundation is composed of five trustees, none of whom has a veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered to be controlled directly or indirectly by one or more disqualified persons by reason of this fact alone. However, all pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting rights with respect to stocks in which members of its governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

(2) *Proof of independent control.* —Notwithstanding subparagraph (1) of this paragraph, an organization shall be permitted to establish to the satisfaction of the Commissioner that disqualified persons do not directly or indirectly control it. For example, in the case of a religious organization operated in connection with a church, the fact that the majority of the organization's governing body is composed of lay persons who are substantial contributors to the organization will not disqualify the organization under section 509(a)(3)(C) if a representative of the church, such as a bishop or other official, has control over the policies and decisions of the organization

GOVERNMENT'S POSITION:

As set forth above, it is the government's primary position that the tax exempt status of the ORG should be revoked. Alternatively, the Organization should be reclassified as a private foundation.

Internal Revenue Code (IRC) section 509(a)(3) excepts from the term "private foundation" an organization which is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in IRC sections 509(a)(1) or 509(a)(2). If an organization is a private foundation it is not described in IRC 509(a)(1) or IRC 509(a)(2).

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Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private foundations, private foundations were defined and subjected to significant regulations and controls by the Tax Reform Act of 1969. The definition of a private foundation is intentionally inclusive so that all organizations exempted from tax by IRC § 501(c)(3) are private foundations except for those specified in IRC § 509(a)(1) through(4). Roe Foundation Charitable Trust v. Commissioner, T.C. Memo. 1989-566; Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7th Cir. 1979). Based on the representations made in its application for exemption, the Organization received a determination letter from the Service that classified it as a supporting organization described in section 509(a)(3), rather than as a private foundation. The Organization has never met the requirements for supporting organization classification.

Public charities (organizations described in section 501(c)(3) that meet the requirement of sections 509(a)(1) or (2)) are excepted from private foundation status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private foundations are subject. Supporting organizations are similarly excepted from private foundation status. Supporting organizations are excepted if they are subject to the scrutiny of public charities that provide sufficient oversight to keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie, 603 F.2d at 1277-78.

Section 509(a)(3) organizations must meet all three of the following tests:

- 1) Organizational and Operational Tests under § 509(a)(3)(A). The organization must be organized and operated exclusively for the benefit of, and to perform the functions of, one or more public charities.
- 2) Relationship Test under § 509(a)(3)(B). The organization must be operated, supervised or controlled, by or in connection with, one or more public charities.
- 3) Disqualified Person Control Test under § 509(a)(3)(C). The organization cannot be controlled directly or indirectly by one or more disqualified persons. A disqualified person is described in §4946; it includes a substantial contributor, an officer, director, or trustee of the organization or a family member of the substantial contributor, officer, director or trustee. A family member is defined as spouses, or ancestors, or lineal descendants and their spouses.

Overall, these tests are meant to ensure that a supporting organization is responsive to the needs of a public charity and intimately involved in its operations and that the public charity (or publicly supported organization) is motivated to be attentive to the operations of the supporting organization and that it is not controlled, directly or indirectly, by disqualified persons.

Organizational and Operational Tests

The Organization is not organized to benefit one or more specified publicly supported organizations. Pursuant to Treas. Reg. § 1.509(a)-4(c)(1)(iii) and (iv), an organization's governing instrument must state the specified publicly supported organization(s) on whose behalf the organization is to be operated and cannot expressly empower the organization to support or benefit any organizations other than the

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specified publicly supported organization(s). The governing instrument is the Articles of Incorporation, not the Bylaws. The Articles do not name a specific charity on whose behalf the Organization is going to be operated. Even if the Articles did name CO-1, the Organization's dissolution clause allows distributions to any section 501(c)(3) organization that its directors select upon its termination. Distributions are not limited to CO-1 if the Organization terminates. Therefore, the organizational test is not met. See Quarrie, supra (holding that the organizational test was not satisfied where the trustee had the power to substitute beneficiaries when in the judgment of the trustees, the uses of the named beneficiaries became unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public).

Regulation 1.509(a)-4(c)(1) requires that the Organization only give grants to specified beneficiaries. Specified beneficiaries are those that are named in the organizing document. The Organization only paid one grant and that grant was to the . This was not specified as the supported organization in the organizational document. Furthermore, the Organization has operated for the benefit of a disqualified person, i.e. its Founder. Therefore, the operational test is not met.

Relationship Test

As set forth in Treas. Reg. § 1.509(a)-4(f)(2), there are three permissible relationships: (a) operated, supervised, or controlled by; (b) supervised or controlled in connection with; and (c) operated in connection with one or more publicly supported organizations.

In order to meet the first of these tests the publicly supported charity has to appoint the majority of board members of the supporting organization. To meet the second test the supporting organization and supported organization have to have the same persons in control. There are only two board members. Founder and Founder 2. No public charity appointed a majority of the Organization's board. There is no commonality of control between the Organization and any public charity. Therefore, the requirements to satisfy the first two types of relationship have not been satisfied.

The third and final relationship possible for section 509(a)(3) organizations is the "operated in connection with" relationship which requires that the supporting organization be **responsive** to the needs or demands of the publicly supported organization and constitute an **integral part** of, or maintain a significant involvement in the affairs of the publicly supported organization. This relationship is satisfied where the supporting organization meets both the "responsiveness" and "integral part" tests. Neither test has been satisfied here.

In order to meet the responsiveness test, either Treas. Reg. § 1.509(a)-4(i)(2)(ii) or (iii) must be satisfied. Treas. Reg. § 1.509(a)-4(i)(2)(ii) requires that the board member appointed by the supported organization have a significant voice in the operations of the supporting organization. A board member was not appointed by any public charity. Therefore, a board member appointed by a supported organization could not have any input into the investment policies of the Organization or into the timing of grants or the selection of recipients.

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Alternatively, the supporting organization must be a charitable trust under state law and each specified publicly supported organization must be a named beneficiary under the charitable trust's governing instrument and the beneficiary organization must have the power to enforce the trust and compel an accounting under state law. Treas. Reg. § 1.509(a)-4(i)(2)(iii). The Organization is not a trust, there is no public charity named in the Articles of Incorporation, and no beneficiary organization has the power to enforce the governing instrument.

Therefore, the Organization does not meet either of the "responsiveness" tests.

While the responsiveness test guarantees that the publicly supported organization can influence the activities of the supporting organization, the integral part test ensures that the publicly supported organization will be motivated to attend to the operations of the supporting organization. The integral part test is considered to have been satisfied if the supporting organization maintains a significant involvement in the operations of one or more publicly supported organizations and the publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. Treas. Reg. § 1.509(a)-4(i)(3)(i). In order to meet the integral part test, either Treas. Reg. § 1.509-4(i)(3)(ii) or (iii) must be satisfied.

Treas. Reg. § 1.509(a)-4(i)(3)(ii) provides that the activities engaged in for or on behalf of the publicly supported organizations must be activities to perform the functions of, or to carry out the purposes of, such organizations and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves. Thus, this part of the integral part test applies in those situations in which the supporting organization actually engages in activities which benefit the publicly supported organizations as opposed to simply making grants to the publicly supported organizations. Compare to Treas. Reg. § 1.509(a)-4(i)(3)(iii) (which sets forth the rules of the integral part test applicable to supporting organizations that make payments to or for the use of publicly supported organizations), see also Roe Foundation, T.C. Memo. 1989-566; Cuddeback Memorial Fund v. Commissioner, T.C. Memo. 20XX-300. The Organization does not meet this test because, while it made one grant to a church, it did not perform any activities for or on behalf of any publicly supported organization.

Because the Organization did not perform any activities for or on behalf of publicly supported organizations aside from one grant, the applicable rules for satisfying the integral part test are in Treas. Reg. § 1.509(a)-4(i)(3)(iii). This section of the regulation has the following 3 basic requirements: 1) payment of substantially all of its income to publicly supported organizations; 2) the amount received by one publicly supported organization must be sufficient to motivate it to pay attention to the operations of the supporting organization; and 3) a substantial amount of the total support of the organization must go to those publicly supported organizations that meet the attentiveness requirement. In the present situation, the first requirement is moot because the Organization had no income during any year examined because Founder paid no interest on his purported loan from the Organization. The Organization does not meet the second requirement. Because it has not met the second requirement, it cannot meet the third requirement.

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All facts and circumstances are considered in determining whether the "substantially all" requirement is satisfied. Where there is a permanent accumulation of income, or where there is an accumulation of income for an extended period without apparent purpose, the "substantially all" requirement will not be met. While there is no absolute rule with respect to the timing of the distributions, in general a supporting organization will satisfy the "substantially all" requirement if it distributes 85 percent or more of its income to specified publicly supported organizations no later than the end of the year following the year the income is realized.

Generally, income for purpose of applying the 85 percent test is reduced by related expenses and excludes contributions received and long-term capital gains. Also, consistent with section 53.4942(a)-3(e) of the private foundation excise tax regulations, a supporting organization may carryover excess distributions for five years following the year in which the excess distribution was made. As was previously stated, this requirement is moot because the Organization had no net income (excluding the long-term gain) during the years examined.

Treas. Reg. § 1.509(a)-4(i)(3)(iii)(a) provides that the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. Treas. Reg. § 1.509(a)-4(i)(3)(iii)(b) provides that a supporting organization can meet the attentiveness requirement, even where the amount of support received by the publicly supported organization does not represent a sufficient part of the publicly supported organization's total support, if it can be demonstrated that support is earmarked for a substantial program of the publicly supported organization that would be interrupted without the supporting organization's support. And finally, Treas. Reg. § 1.509(a)-4(i)(3)(d) provides that "[a]ll pertinent factors. . . will be considered in determining whether the amount of support received by a publicly supported organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization." It goes on to note the importance of the percentage of the income received from the supporting organization is in determining if the publicly supported organization will have the requisite degree of attentiveness and concludes that evidence of actual attentiveness is almost as important.

The Organization made one grant during its existence. In 20XX, it made a grant of \$ to the . No grants were made in any other year. No public charity is listed in the Organization's Articles to receive support. The Organization's By-Laws, its Forms 990 and its application for exemption all stated the Organization would support CO-1. No grant has ever been made to CO-1. CO-1's Forms 990 for 20XX to 20XX show that it had total revenues exceeding \$ per year. Obviously, the Organization's grants of -0- are not a sufficient part of CO-1's total support to ensure its attentiveness. There were no grants so they could not be earmarked, much less earmarked for a substantial program of CO-1 that would be interrupted without the grants. There are no indicia of attentiveness like board representation or provision of financial statements.

In addition, the facts and circumstances show that the support is not sufficient to ensure that the supported organization is attentive to the operations of the Organization. No public charity including CO-1 appointed any board member to represent it. No public charity paid sufficient attention to the Organization's operations to prevent Founder from taking all of the Organization's assets for his own

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benefit. There is no indication that any alternative investments were considered. There is no assurance that the Organization will demand payment on the note or will attempt to enforce collection. Thus, no public charity was attentive to the Organization's operations. See Treas. Reg. § 1.509(a)-4(i)(3)(iii).

Neither integral part test was satisfied.

Control Test

To qualify as a supporting organization, the organization cannot be controlled directly or indirectly by one or more disqualified persons. Treas. Reg. § 1.509(a)-4(j)(1) provides that for purposes of section 509(a)(3)(C), an organization will be considered "controlled" if the person, by reason of his position or authority, may require the organization to perform any act which significantly affects its operations or prevents such organization from performing such act. All facts and circumstances are taken into consideration in determining whether a disqualified person controls an organization. Id. The Organization's board consists of two members, the Founder and his wife. As founders, substantial contributors, and board members of the Organization, Founder and Founder 2 are disqualified persons. Although other individuals were listed in the Application as board members, they have not exercised any independence with respect to the governance of the Organization, in either its investments or operations. They are not listed as board members on the Forms 990 for 20XX-20XX. There is no indication that any public charity ever took part in any of the decisions of the investments or grants paid out. In addition, to determine control, the Organization's assets must be examined. The only asset is a note owed by Founder to the Organization which does not require regular interest payments. Nothing needs to be paid on this note until the Organization makes demand. The existence and terms of the note also support a determination that disqualified persons control the Organization. Accordingly, the control test has not been satisfied.

Conclusion

Accordingly, if its exempt status is not revoked, the Organization should be reclassified as a private foundation because it does not qualify as a supporting organization under the requirements set forth in Treas. Reg. § 1.509(a)-4(c) through (j).

This modification of private foundation status is effective beginning June 9, 19XX. The Organization represented in its exemption application that it would support CO-1. It did not support CO-1 or any public charity. It represented that it would have four board members in addition to Founders. It did not. All of its assets were transferred to its Founder. The Organization represented that the Primary Charity would be attentive to its operations and that it would approve all directors and all investments. It did not. Therefore, retroactive reclassification is applicable.

The effect of this determination will be that the Organization is required to file Form 990-PF Return of Private Foundation. Form 990-PF should be filed for tax years ending December 31, 20XX and December 31, 20XX and December 31, 20XX. Subsequent returns are due no later than the 15th day of the 5th month following the close of the Foundation's accounting period. For tax year ending December 31, 20XX, Form 990 PF is due May 15, 20XX.

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Send your returns to the following mailing address:

Internal Revenue Service

Note:

Form 990-PF is required for each tax year until Private Foundation status is terminated under IRC 507.